

FINANCIAL STATEMENTS AND
OTHER FINANCIAL INFORMATION

Southwest Catholic Health Network Corporation
Years Ended June 30, 2007 and 2006

Report of Independent Auditors

The Board of Directors
Southwest Catholic Health Network Corporation

We have audited the accompanying statements of financial position of Southwest Catholic Health Network Corporation (SCHN) as of June 30, 2007 and 2006, and the related statements of activities and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of SCHN's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of SCHN's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of SCHN's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Southwest Catholic Health Network Corporation as of June 30, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

November 12, 2007

Southwest Catholic Health Network Corporation

Statements of Financial Position

(In thousands)

| | June 30 | |
|--|------------|------------|
| | 2007 | 2006 |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 118,790 | \$ 92,298 |
| Short-term investments | 45,018 | 31,913 |
| Reinsurance receivables | 45,499 | 40,160 |
| Reconciliation receivables, net of allowance for doubtful accounts of \$7,130 and \$2,120 as of June 30, 2007 and 2006, respectively | 53,739 | 21,469 |
| Capitation and supplement receivables | 5,438 | 3,948 |
| Interest receivable | 931 | 686 |
| Provider advances, net of allowance for doubtful accounts of \$1,470 and \$2,390 as of June 30, 2007 and 2006, respectively | 15,382 | 16,408 |
| Due from Schaller Anderson of Arizona | — | 704 |
| Other current assets | 4,801 | 5,328 |
| Total current assets | 289,598 | 212,914 |
| Long-term investments | 121,515 | 105,345 |
| Pension asset | 261 | 29 |
| Total assets | \$ 411,374 | \$ 318,288 |
| Liabilities and net assets | | |
| Current liabilities: | | |
| Medical claims payable | \$ 239,390 | \$ 214,819 |
| Deferred revenue | 19,099 | 19,950 |
| Due to Schaller Anderson of Arizona | 269 | — |
| Other current liabilities | 4,871 | 5,399 |
| Current portion of risk share settlement | 16,477 | — |
| Total current liabilities | 280,106 | 240,168 |
| Risk share settlement, net of current portion | 1,390 | 8,469 |
| Net assets | 129,878 | 69,651 |
| Total liabilities and net assets | \$ 411,374 | \$ 318,288 |

See accompanying notes.

Southwest Catholic Health Network Corporation

Statements of Activities and Changes in Net Assets

(In thousands)

| | Years Ended June 30 | |
|--|---------------------|--------------|
| | 2007 | 2006 |
| Revenue: | | |
| Capitation premiums | \$ 1,405,169 | \$ 1,183,880 |
| Delivery/hospital/HIV-AIDS supplement | 90,288 | 84,233 |
| Reinsurance | 123,620 | 64,348 |
| Other, primarily third-party recoveries | 3,674 | 4,158 |
| Total revenue | 1,622,751 | 1,336,619 |
| Health care expenses: | | |
| Hospitalization | 448,599 | 345,344 |
| Medical compensation | 225,554 | 191,356 |
| Ancillary and other medical services | 536,358 | 451,555 |
| Institutional | 138,144 | 111,297 |
| Home and community based services | 89,611 | 82,080 |
| Total health care expenses | 1,438,266 | 1,181,632 |
| General and administrative expenses | 119,309 | 97,960 |
| Premium tax expense | 26,081 | 23,906 |
| Total expenses | 1,583,656 | 1,303,498 |
| Operating income | 39,095 | 33,121 |
| Nonoperating gains (losses): | | |
| Investment income | 16,566 | 10,291 |
| Other | (726) | (494) |
| Total nonoperating income | 15,840 | 9,797 |
| Excess of revenue over expenses | 54,935 | 42,918 |
| Minimum pension obligation | (67) | 562 |
| Equity distributions to sponsor organizations | — | (20,000) |
| Net change in unrealized gains (losses) on investments | 5,359 | (723) |
| Increase in net assets | 60,227 | 22,757 |
| Net assets at beginning of year | 69,651 | 46,894 |
| Net assets at end of year | \$ 129,878 | \$ 69,651 |

See accompanying notes.

Southwest Catholic Health Network Corporation

Statements of Cash Flows

(In thousands)

| | Years Ended June 30 | |
|---|---------------------|-----------|
| | 2007 | 2006 |
| Operating activities | | |
| Increase in net assets | \$ 60,227 | \$ 22,757 |
| Equity distributions to sponsor organizations | — | 20,000 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | |
| Pension asset | (232) | (1,163) |
| Net unrealized gains (losses) on investments | (5,359) | 723 |
| Changes in operating assets and liabilities: | | |
| Reinsurance receivables | (5,339) | 10,761 |
| Reconciliation receivables | (32,270) | (9,783) |
| Capitation and supplement receivables | (1,490) | 1,239 |
| Interest receivable | (245) | (194) |
| Provider advances | 1,026 | (6,397) |
| Due to/from Schaller Anderson of Arizona | 973 | (581) |
| Other current assets | 527 | (1,619) |
| Medical claims payable | 24,571 | 71,038 |
| Deferred revenue | (851) | 19,950 |
| Risk share settlement | 9,398 | 8,469 |
| Other current liabilities | (528) | 5,205 |
| Net cash provided by operating activities | 50,408 | 140,405 |
| Investing activities | | |
| Purchases of investments | (137,621) | (116,622) |
| Proceeds from sale of investments | 113,705 | 66,180 |
| Net cash used in investing activities | (23,916) | (50,442) |
| Financing activities | | |
| Equity distributions to sponsor organizations | — | (20,000) |
| Net cash used in financing activities | — | (20,000) |
| Increase in cash and cash equivalents | 26,492 | 69,963 |
| Cash and cash equivalents at beginning of year | 92,298 | 22,335 |
| Cash and cash equivalents at end of year | \$ 118,790 | \$ 92,298 |

See accompanying notes.

Southwest Catholic Health Network Corporation

Notes to Financial Statements

June 30, 2007

1. Description of Business

Southwest Catholic Health Network Corporation (SCHN, or the Plan) is a nonprofit corporation, exempt from federal and state income taxes, whose sponsor organizations are Catholic Healthcare West Arizona (CHW Arizona) and Carondelet Health Care Corporation of Arizona (Carondelet), collectively the “sponsors.”

SCHN provides medical care under contract with the Arizona Health Care Cost Containment System (AHCCCS), the State of Arizona’s Medicaid system. SCHN is also under contract with the AHCCCS Health Care Group (HCG) to provide medical care to qualified commercial small businesses, and the Arizona Long Term Care System (ALTCS) to provide institutional care, home and community based services and behavioral health services to the long term care members. SCHN also provides medical care to qualified members through a contract with the Arizona Department of Economic Security Division of Developmental Disabilities (DES/DDD).

Effective January 1, 2006 SCHN entered into a Medicare Advantage Plan (Medicare Advantage) with the Centers for Medicare and Medicaid Services (CMS), offering medical and prescription drug benefits to qualified members. Medicare Advantage operates as a special needs plan under CMS guidelines. The populations covered under Medicare Advantage are members who are eligible for both Medicare and Medicaid coverage. Virtually all of the members of Medicare Advantage receive their Medicaid benefits through one of SCHN’s AHCCCS contracts.

SCHN has entered into a management agreement with Schaller Anderson of Arizona (SAA). Under the terms of the agreement, SCHN pays a monthly fee to SAA, as defined in the agreement, to cover the employee salary and benefit costs and general and administrative expenses incurred to operate the Plan.

2. Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents include short-term money market accounts, and investments with a maturity from date of purchase of three months or less.

Southwest Catholic Health Network Corporation

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

Investments

SCHN's investment portfolio is managed by professional investment managers within guidelines established by SCHN's Board of Directors which, as a matter of policy, limits the amounts which may be invested in any one issuer or type of investment. Investments in equity securities and preferred securities with readily determinable fair values, and all investments in debt securities and mortgage backed securities are measured at fair value in the statements of financial position. Fair value is based on quoted market prices. SCHN classifies its investments in marketable equity securities as other than trading because they are held for an indefinite period of time and the terms of the investment manager agreements limit the ability of the managers to execute investment transactions.

Investment income (including realized gains and losses on investments, interest and dividends) is included in the excess of revenue over expenses. Unrealized gains and losses on investments are excluded from the excess of revenue over expenses and are reflected as a change in net assets. SCHN has a policy to review and identify investments with declines in value that would be considered to be other-than-temporary. Such other-than-temporary declines, if significant, are accounted for as realized losses.

Revenue Recognition

Capitation Premiums: Capitation premiums are recognized in the month that enrollees are entitled to health care services. Certain provisions of the AHCCCS Acute, HCG, and ALTCS contracts include a risk band whereby SCHN and the AHCCCS programs share in the profits and losses of the contract, as defined in the respective contracts (reconciliation revenue). SCHN has recorded an estimate of the reconciliation revenue, within capitation premiums, based on the operational performance of the AHCCCS Acute, HCG and ALTCS lines of business.

Delivery/Hospital/HIV-AIDS Supplement: Delivery supplemental revenue is reimbursement from AHCCCS intended to cover the cost of maternity care. Such premiums are recognized in the month that the delivery occurs.

Hospital supplemental revenue is reimbursement from AHCCCS for certain members who are in an inpatient setting on the date of application for AHCCCS eligibility. This additional one-time reimbursement is intended to help the Plan defray medical costs associated with inpatient stays. Such premiums are recognized in the month that SCHN is informed of the patients' eligibility and services are rendered.

Southwest Catholic Health Network Corporation

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

HIV-AIDS supplemental revenue is reimbursement from AHCCCS intended to help defray the costs of HIV/AIDS drugs. Such premiums are recognized in the month that services are rendered.

Reinsurance: Reinsurance revenue is stated at the actual and estimated amounts due to SCHN pursuant to the AHCCCS Acute, DES/DDD, HCG, ALTCS and Medicare Advantage Plan contracts. Below are the reinsurance thresholds by line of business:

| Line of Business | Annual Deductible | Coinsurance |
|---|----------------------|-------------|
| AHCCCS Acute – Prospective Only | \$ 20,000 | 75% |
| Title XIX Waiver Group – Prospective Only | 15,000 | 75 |
| DES/DDD | 20,000 | 75 |
| DES/DDD Ventilator Dependent | No deductible | 100 |
| HCG | 125,000 | 90 |
| ALTCS w/Medicare | 20,000 | 75 |
| ALTCS w/o Medicare | 30,000 | 75 |
| Medicare Advantage | 125,000 | 90 |

To be eligible for reinsurance billing, qualified healthcare expenses must be incurred during the contract year. Reinsurance revenue is recorded based on actual billed reinsurance claims adjusted for medical cost completion factors and SCHN's historical collection experience. Reinsurance revenue is subject to review by AHCCCS, and as a result, there is at least a reasonable possibility that recorded reinsurance revenue will change by a material amount in the near future.

Accounts Receivable Allowances

The provision for bad debts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions. Periodically throughout the year, management assesses the adequacy of the allowance for doubtful accounts based upon historical write-off experience by plan year. The results of this review are used to make any modifications to the provision for bad debts to establish an appropriate allowance for doubtful accounts.

Southwest Catholic Health Network Corporation

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

Deferred Revenue

Medicare Advantage capitation premiums received in the month prior to enrollee coverage are deferred and recognized in revenue in the succeeding month.

Risk Share Settlement

The risk share settlement represents expected payments to be paid to CMS in connection with the pharmacy component of Medicare Advantage. This balance is reviewed and monitored by management and adjusted as necessary as experience develops or new information becomes available. Such adjustments are netted against the capitation premiums on the statements of activities and changes in net assets. The pharmacy risk share settlement, recorded at June 30, 2007, is expected to be finalized as follows:

- Calendar year 2006 will be finalized in late 2007, recorded as a current liability
- Calendar year 2007 will be finalized in late 2008, recorded as a long term liability

Health Care Expenses

Expenses for hospitalization, medical compensation, ancillary and other medical services, institutional, and home and community based services include management's estimates for incurred but unreported claims for healthcare services rendered by providers during the year. These estimates are based on SCHN experience and are continually reviewed by management and adjusted as necessary based on current claims data, and medical cost completion factors. Such adjustments are included in health care expenses in the statements of activities and changes in net assets. There is at least a reasonable possibility that the recorded estimates will change by a material amount, in the near future.

Southwest Catholic Health Network Corporation

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Excess of revenues over expenses increased by approximately \$10,400,000, for the year ended June 30, 2007 as a result of a change in estimate to the June 30, 2006 reinsurance receivables allowance due to improved collections.. Excess of revenues over expenses increased by approximately \$10,000,000 for the year ended June 30, 2006 as a result of a change in estimate to the June 30, 2005 medical claim payable and reinsurance receivables.

Reclassifications

Certain reclassifications have been made to the 2006 financial statements to conform to the 2007 financial statement presentation.

Premium Deficiency Reserve

As a result of continuing operating losses sustained, incurred from one component of the AHCCCS contract, for which the annual premium is not sufficient to cover the operating losses, SCHN recorded a premium deficiency reserve of \$5,800,000. Management believes the reserve is adequate to cover future losses through the end of the current contract year ending September 30, 2007. The premium deficiency reserve is recorded within claims liability on the statements of financial position as of June 30, 2007.

3. Other Current Assets

Other current assets consist of the following at June 30:

| | 2007 | 2006 |
|-------------------------------------|-----------------------|-----------------|
| | <i>(In Thousands)</i> | |
| Pharmacy rebates | \$ 2,089 | \$ 3,112 |
| Receivables from third party payers | 2,057 | 1,635 |
| Prepaid expenses and other | 655 | 581 |
| | <u>\$ 4,801</u> | <u>\$ 5,328</u> |

Southwest Catholic Health Network Corporation

Notes to Financial Statements (continued)

4. Investments

The cost and fair value of SCHN's investments by type at June 30 are as follows:

| | 2007 | | 2006 | |
|------------------------------|-----------------------|-------------------|-------------------|-------------------|
| | Cost | Fair Value | Cost | Fair Value |
| | <i>(In Thousands)</i> | | | |
| Short-term: | | | | |
| Mutual funds | \$ 25,766 | \$ 25,766 | \$ 23,065 | \$ 23,066 |
| Corporate bonds | 7,808 | 7,824 | 6,109 | 5,892 |
| U.S. Government securities | 11,354 | 11,428 | 2,962 | 2,955 |
| | <u>44,928</u> | <u>45,018</u> | <u>32,136</u> | <u>31,913</u> |
| Long-term: | | | | |
| Marketable equity securities | 47,650 | 57,193 | 43,159 | 47,960 |
| U.S. Government securities | 27,715 | 27,383 | 28,280 | 27,761 |
| Corporate bonds | 13,176 | 13,092 | 15,011 | 14,738 |
| Mortgage-backed securities | 20,888 | 20,439 | 13,492 | 13,078 |
| Preferred securities | 3,492 | 3,408 | 1,855 | 1,808 |
| | <u>112,921</u> | <u>121,515</u> | <u>101,797</u> | <u>105,345</u> |
| | <u>\$ 157,849</u> | <u>\$ 166,533</u> | <u>\$ 133,933</u> | <u>\$ 137,258</u> |

Investment income for the years ended June 30 is comprised of the following:

| | 2007 | 2006 |
|--|-----------------------|------------------|
| | <i>(In Thousands)</i> | |
| Revenue (included in nonoperating investment income): | | |
| Interest income | \$ 11,782 | \$ 7,265 |
| Realized gains on sales of investments | 4,784 | 3,026 |
| | <u>\$ 16,566</u> | <u>\$ 10,291</u> |
| Other changes in net assets: | | |
| Net change in unrealized gains (losses) on investments | \$ 5,359 | \$ (723) |

Southwest Catholic Health Network Corporation

Notes to Financial Statements (continued)

4. Investments (continued)

Management continually reviews its investment portfolio and evaluates whether declines in the fair value of securities should be considered other-than-temporary. Factored into this evaluation are the general market conditions, the issuer's financial condition and near-term prospects, conditions in the issuer's industry, the recommendation of advisors, the length of time and extent to which the market value has been less than cost, and SCHN's ability and intent to hold these investments until recovery of fair value. During the years ended June 30, 2007 and 2006, SCHN did not record a realized loss for other-than-temporary declines in the fair value of investments.

The following table summarizes the unrealized losses on investments held at June 30, 2007 (in thousands):

| Description of Securities | Less than Twelve Months | | Twelve Months or Longer | | Total | |
|------------------------------|-------------------------|----------|-------------------------|--------|------------|----------|
| | Unrealized | | Unrealized | | Unrealized | |
| | Fair Value | Losses | Fair Value | Losses | Fair Value | Losses |
| U.S. Government securities | \$ 13,265 | \$ 192 | \$ 7,534 | \$ 242 | \$ 20,799 | \$ 434 |
| Marketable equity securities | 10,903 | 572 | 1,097 | 54 | 12,000 | 626 |
| Corporate bonds | 3,880 | 48 | 5,392 | 156 | 9,272 | 204 |
| Mortgage-backed securities | 9,027 | 266 | 8,869 | 215 | 17,896 | 481 |
| Preferred securities | 1,584 | 53 | 1,250 | 39 | 2,834 | 92 |
| Total | \$ 38,659 | \$ 1,131 | \$ 24,142 | \$ 706 | \$ 62,801 | \$ 1,837 |

The following table summarizes the unrealized losses on investments held at June 30, 2006 (in thousands):

| Description of Securities | Less than Twelve Months | | Twelve Months or Longer | | Total | |
|------------------------------|-------------------------|----------|-------------------------|----------|------------|----------|
| | Unrealized | | Unrealized | | Unrealized | |
| | Fair Value | Losses | Fair Value | Losses | Fair Value | Losses |
| U.S. Government securities | \$ 20,098 | \$ 229 | \$ 3,919 | \$ 306 | \$ 24,017 | \$ 535 |
| Marketable equity securities | 11,697 | 883 | 2,451 | 699 | 14,148 | 1,582 |
| Corporate bonds | 10,931 | 150 | 7,945 | 341 | 18,876 | 491 |
| Mortgage-backed securities | 6,754 | 168 | 6,074 | 246 | 12,828 | 414 |
| Preferred securities | - | - | 1,291 | 61 | 1,291 | 61 |
| Total | \$ 49,480 | \$ 1,430 | \$ 21,680 | \$ 1,653 | \$ 71,160 | \$ 3,083 |

Southwest Catholic Health Network Corporation

Notes to Financial Statements (continued)

4. Investments (continued)

Long-term investments can be liquidated without significant penalty within twenty-four hours, and are considered short-term for purposes of calculating current ratios under AHCCCS reporting guidelines.

5. Related Party Transactions

SCHN paid approximately \$95,091,000 in 2007 and \$78,350,000 in 2006 to CHW Arizona and approximately \$31,248,000 in 2007 and \$20,657,000 in 2006 to Carondelet for hospitalization and other medical services provided to its members. These balances include net prospective provider advance payments made to CHW Arizona and Carondelet. In June 2006, SCHN paid out equity distributions of \$10,000,000 each to CHW Arizona and Carondelet. On July 20, 2007, the Finance Committee approved equity distributions of \$19,000,000 each to CHW Arizona and Carondelet which are expected to be paid in September 2007.

6. Leases

SCHN has an agreement to lease certain office space in Phoenix. During the term of the SAA agreement, SAA is responsible for reimbursing SCHN for the lease payments. The lease agreement contains scheduled rent escalations, and the lease has an option to renew the lease for five years. SCHN will allow the lease to expire in January 2008. Future minimum lease payments through the end of the lease term amount to \$890,000.

Rent expense was approximately \$1,578,000 in 2007 and \$1,681,000 in 2006.

7. Retirement Benefits

SCHN has a noncontributory defined benefit pension plan (Pension Plan) covering all eligible employees. All employees were covered on the first day of the month coincident with the completion of one year of service. Plan benefits were based on the employee's career compensation.

Southwest Catholic Health Network Corporation

Notes to Financial Statements (continued)

7. Retirement Benefits (continued)

Effective May 31, 2002, the defined benefit pension plan was frozen based on salaries earned through April 30, 2002. SCHN will continue to make annual contributions to the defined benefit pension plan in amounts sufficient to meet the minimum funding requirements of the Employment Retirement Income Security Act (ERISA). In July 2006, the Board of Directors of SCHN voted to terminate the Pension Plan. The Pension Plan will be fully funded, and vested amounts distributed, during fiscal year 2008.

On June 30, 2007, SCHN adopted the recognition and disclosure provisions of FAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (FAS 158). FAS 158 required SCHN to recognize the funded status (i.e., the difference between the fair value of plan assets and the projected benefit obligation) of its defined pension plan in the June 30, 2007 statement of financial position. The adoption of FAS 158 did not have any affect on the recognition of the funded status of the Pension Plan.

SCHN uses a measurement date of July 1 for the Pension Plan. The amount due Plan participants at termination will likely differ from the projected benefit obligation reflected in the table below. The following table sets forth the pension plan funded status as provided by independent actuaries at July 1:

| | 2007 | 2006 |
|--|----------------|----------------|
| | (In Thousands) | |
| Projected benefit obligation | \$ 3,667 | \$ 3,379 |
| Fair value of plan assets | 3,928 | 3,408 |
| Funded status of the plan | <u>\$ 261</u> | <u>\$ 29</u> |
| Components of net periodic benefit cost: | | |
| Interest cost | \$ 228 | \$ 218 |
| Expected return on plan assets | (326) | (285) |
| Recognized net actuarial loss | 19 | 17 |
| Total net periodic pension cost | <u>\$ (79)</u> | <u>\$ (50)</u> |
| Unrecognized net actuarial loss | \$ 1,010 | \$ 893 |
| Employer contributions | \$ 300 | \$ 600 |
| Benefits paid | \$ 111 | \$ 158 |

Southwest Catholic Health Network Corporation

Notes to Financial Statements (continued)

7. Retirement Benefits (continued)

Weighted-average assumptions used to determine net periodic pension cost were as follows as of June 30:

| | 2007 | 2006 |
|--------------------------------|-------|-------|
| Discount rate | 6.25% | 6.50% |
| Expected return on plan assets | 8.00% | 8.00% |

Due to the planned termination of the Pension Plan in fiscal year 2008, SCHN has liquidated the Plan's assets. Accordingly, all Plan assets are held in cash and cash equivalents at June 30, 2007.

SCHN anticipates making a \$225,000 contribution to the Pension Plan during 2008.

8. Commitments and Contingencies

At June 30, 2007 and 2006, SCHN has irrevocable standby letters of credit to satisfy the AHCCCS Acute, DES/DDD and ALTCS general performance bond requirements. Total amounts available are \$61,650,000 at June 30, 2007. No draws have been made on the letter of credit as of June 30, 2007. The letters of credit are collateralized by investments of SCHN. To meet Medicare requirements, SCHN has entered into a note agreement with CHW Arizona and Carondelet which allows SCHN to draw, upon demand, up to a combined maximum amount of \$10,000,000. There were no draws on the note agreement as of June 30, 2007.

Under the terms of the AHCCCS contract, SCHN is required to meet certain financial covenants. As of June 30, 2007, SCHN is in compliance with the AHCCCS covenants with the exception of the current ratio under the HCG. SCHN obtained a waiver for a current ratio noncompliance from HCG.

SCHN is involved in litigation and regulatory investigations arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters are expected to be resolved without material adverse effect on SCHN's financial position.

SCHN is involved in grievances associated with its operations. Included in these matters is a grievance filed by various hospitals challenging payments they are receiving from the State of Arizona and health plans under the AHCCCS reimbursement system, which was implemented on March 1, 1993. The hospitals seek retrospective and prospective relief. SCHN has denied liability in this matter on the basis that the rates are imposed by AHCCCS. Management believes that any resulting liability, if any, will not materially affect SCHN's financial position.

Southwest Catholic Health Network Corporation

Notes to Financial Statements (continued)

8. Commitments and Contingencies

Future contract awards are contingent upon the continuation of the AHCCCS Acute, DES/DDD, HCG, and ALTCS programs by the State of Arizona and SCHN's ability and desire to retain its status as a contractor under these programs. The AHCCCS Acute contract expires on September 30, 2007, with one one-year renewal option. The renewal option was exercised on October 1, 2007. The ALTCS contract expires on September 30, 2009, with two one-year renewal options. The DES/DDD contract expires on September 30, 2007 with annual renewal options. The DES/DDD contract was renewed on October 1, 2007 for one year. The HCG contract expires June 30, 2008. The Medicare Advantage contract is renewed annually by CMS.

Southwest Catholic Health Network Corporation

Details of Statement of Financial Position

Year Ended June 30, 2007

| | AHCCCS | DES/DDD | HCG | ALTCS | Medicare | Total |
|--|-----------------------|-----------|----------|------------|-----------|------------|
| | <i>(In thousands)</i> | | | | | |
| Assets | | | | | | |
| Current assets: | | | | | | |
| Cash and cash equivalents | \$ 23,673 | \$ - | \$ - | \$ - | \$ 95,117 | \$ 118,790 |
| Short-term investments | 23,831 | 2,379 | 1,464 | 14,750 | 2,594 | 45,018 |
| Reinsurance receivables | 29,691 | 1,224 | - | 14,584 | - | 45,499 |
| Reconciliation receivables | 38,389 | - | 14,086 | 1,264 | - | 53,739 |
| Capitation and supplemental receivables | 5,340 | 5 | - | 93 | - | 5,438 |
| Interest receivable | 517 | 46 | 29 | 288 | 51 | 931 |
| Provider advances | 9,363 | 368 | 119 | 3,424 | 2,108 | 15,382 |
| Intercompany | (31,754) | 980 | (14,410) | 58,796 | (13,612) | - |
| Other current assets | 3,810 | 82 | 176 | 89 | 644 | 4,801 |
| Total current assets | 102,860 | 5,084 | 1,464 | 93,288 | 86,902 | 289,598 |
| Long-term investments | 64,326 | 6,423 | 3,951 | 39,813 | 7,002 | 121,515 |
| Pension asset | 261 | - | - | - | - | 261 |
| Total assets | \$ 167,447 | \$ 11,507 | \$ 5,415 | \$ 133,101 | \$ 93,904 | \$ 411,374 |
| Liabilities and net assets | | | | | | |
| Current liabilities: | | | | | | |
| Medical claims payable | \$ 142,767 | \$ 3,666 | \$ 5,565 | \$ 48,556 | \$ 38,836 | \$ 239,390 |
| Deferred revenue | - | - | - | - | 19,099 | 19,099 |
| Due to Schaller Anderson of Arizona | 341 | - | - | - | (72) | 269 |
| Other current liabilities | 1,973 | 5 | - | 1,700 | 1,193 | 4,871 |
| Current portion risk share settlement | - | - | - | - | 16,477 | 16,477 |
| Total current liabilities | 145,081 | 3,671 | 5,565 | 50,256 | 75,533 | 280,106 |
| Risk share settlement net of current portion | - | - | - | - | 1,390 | 1,390 |
| Net assets (deficit) | 22,366 | 7,836 | (150) | 82,845 | 16,981 | 129,878 |
| Total liabilities and net assets | \$ 167,447 | \$ 11,507 | \$ 5,415 | \$ 133,101 | \$ 93,904 | \$ 411,374 |

Southwest Catholic Health Network Corporation

Details of Statement of Activities and Changes in Net Assets

Year Ended June 30, 2007

| | AHCCCS | DES/DDD | HCG | ALTCS | Medicare | Total |
|---|-----------------------|-----------|-----------|-----------|------------|-------------|
| | <i>(In thousands)</i> | | | | | |
| Revenue: | | | | | | |
| Capitation premiums | \$789,914 | \$ 26,483 | \$ 39,236 | \$327,726 | \$ 221,810 | \$1,405,169 |
| Delivery/Hospital/HIV-AIDS supplement | 90,110 | 14 | — | 164 | — | 90,288 |
| Reinsurance | 83,177 | 2,967 | 316 | 36,464 | 696 | 123,620 |
| Other | 3,285 | 75 | 106 | 189 | 19 | 3,674 |
| Total revenue | 966,486 | 29,539 | 39,658 | 364,543 | 222,525 | 1,622,751 |
| Health care expenses: | | | | | | |
| Hospitalization | 339,597 | 6,222 | 14,169 | 22,168 | 66,443 | 448,599 |
| Medical compensation | 176,683 | 2,374 | 3,076 | 5,507 | 37,914 | 225,554 |
| Ancillary and other medical services | 382,943 | 17,623 | 19,644 | 44,605 | 71,543 | 536,358 |
| Institutional | — | — | — | 124,587 | 13,557 | 138,144 |
| Home and community based services | — | — | — | 89,611 | — | 89,611 |
| Total health care expenses | 899,223 | 26,219 | 36,889 | 286,478 | 189,457 | 1,438,266 |
| General and administrative expenses | 69,758 | 2,118 | 3,445 | 22,518 | 21,470 | 119,309 |
| Premium tax expense | 18,954 | — | — | 7,127 | — | 26,081 |
| Total expenses | 987,935 | 28,337 | 40,334 | 316,123 | 210,927 | 1,583,656 |
| Operating income (loss) | (21,449) | 1,202 | (676) | 48,420 | 11,598 | 39,095 |
| Nonoperating income: | | | | | | |
| Investment income | 9,386 | 807 | 496 | 4,998 | 879 | 16,566 |
| Other | (726) | — | — | — | — | (726) |
| Total nonoperating income | 8,660 | 807 | 496 | 4,998 | 879 | 15,840 |
| Excess (deficiency) of revenue over expenses | (12,789) | 2,009 | (180) | 53,418 | 12,477 | 54,935 |
| Net change in minimum pension obligation | (67) | — | — | — | — | (67) |
| Net change in unrealized gains on investments | 2,648 | 298 | 269 | 1,756 | 388 | 5,359 |
| (Decrease) increase in net assets | (10,208) | 2,307 | 89 | 55,174 | 12,865 | 60,227 |
| Net assets (deficit) at beginning of year | 32,574 | 5,529 | (239) | 27,671 | 4,116 | 69,651 |
| Net assets (deficit) at end of year | \$ 22,366 | \$ 7,836 | \$ (150) | \$ 82,845 | \$ 16,981 | \$ 129,878 |